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Supreme Court, U.S.
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No. _____

In the

Supreme Court of the United States

October Term, 1988

NORTHWESTERN BELL TELEPHONE COMPANY,
Petitioner,

v.

MINNESOTA PUBLIC UTILITIES COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA COURT OF APPEALS

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QUESTIONS PRESENTED

1. Did a federal court order, entered pursuant to the Tunney Act, 15 U.S.C. § 16(e), that required Northwestern Bell's divestiture with a capital structure consisting of forty-five percent debt preempt the Minnesota Public Utilities Commission from imputing to petitioner Northwestern Bell Telephone Company a hypothetical capital structure consisting of 50.1 percent debt?

2. Was Northwestern Bell deprived of its constitutional right to procedural due process?

3. Did the State of Minnesota take Northwestern Bell's property without just compensation?

LIST OF PARTIES AND RULE 28.1 LIST

The parties to the proceedings below were Petitioner Northwestern Bell Telephone Company and Respondent Minnesota Public Utilities Commission. Other parties appearing and participating as Respondents in the Minnesota Court of Appeals were the Attorney General for the State of Minnesota, the Minnesota Department of Public Service and the Minnesota Public Interest Research Group.

Northwestern Bell Telephone Company, an Iowa corporation, is a wholly owned subsidiary of U S West Communications, Inc., which is a wholly owned subsidiary of U S West, Inc.

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MINNESOTA PUBLIC UTILITIES COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE MINNESOTA COURT OF APPEALS

The Petitioner Northwestern Bell Telephone Company respectfully prays that a Writ of Certiorari issue to review the order of the Minnesota Court of Appeals dated December 29, 1987, which affirmed final Orders of the Minnesota Public Utilities Commission dated April 2 and 3, 1987, re-opening and re-deciding a three-year-old final telephone rate proceeding.

OPINIONS BELOW

The opinion of the Minnesota Court of Appeals is reprinted at 417 N.W.2d 274, *infra* at p. A-181. The Minnesota Supreme Court denied review of the decision of the Court of Appeals by order dated March 18, 1988, and denied rehearing by order dated April 4, 1988. Neither those orders nor the orders of the Minnesota Public Utilities Commission dated April 2 and 3, 1987, have been reported. They are reprinted in the Appendix hereto at pp. A-203, A-215, A-111, and A-129 *infra*, respectively.

JURISDICTION

The jurisdiction of this Court to review by writ of certiorari the action of the Minnesota Court of Appeals is invoked under 28 U.S.C. § 1257(3).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, Clause 2:

"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

United States Constitution, Fifth Amendment:

"... nor shall private property be taken for public use, without just compensation ..."

United States Constitution, Fourteenth Amendment, Section 1:

"No State shall make or enforce any law which shall abridge the privileges and immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law ..."

Tunney Act, 15 U.S.C. § 16(e):

"Before entering any consent judgment proposed by the United States under this section, the court shall determine that the entry of such judgment is in the public interest. For the purpose of such determination, the court may consider —

...

(2) the impact of entry of such judgment upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of issues at trial."

STATEMENT OF THE CASE

This Petition for Certiorari seeks review of the affirmance of two Minnesota Public Utilities Commission ("Commission") Orders that re-opened a three-year-old final telephone rate case and prospectively lowered the annual revenue of Northwestern Bell Telephone Company ("Northwestern Bell") by over twelve million dollars. Ten million dollars of this revenue reduction resulted from the Commission's change of its 1984 position on a single issue—the appropriateness of Northwestern Bell's debt-equity ratio—which is directly contrary to federal court order.

This case has a complex procedural history, which commenced when Northwestern Bell filed a petition for a $109 million annual telephone rate increase on September 29, 1983. The rate case must, however, be addressed in the context of the then ongoing divestiture of Northwestern Bell from American Telephone & Telegraph Company ("AT&T").

1. Divestiture and the Debt Ratio Required by the Federal District Court.

Prior to 1983, Northwestern Bell and the other Bell operating companies, which at that time were still wholly owned subsidiaries of AT&T, provided a wide range of inter-related telecommunications products and services. At that time, the federal government's antitrust action against AT&T and certain affiliated companies was pending in the United States District Court for the District of Columbia. *See United States v. American Telephone & Telegraph Co.*, 552 F.Supp. 131 (D.D.C. 1982). The United States had, *inter alia*, alleged Sherman Act violations and sought the divestiture from AT&T of the Bell operating companies. Northwestern Bell was one of those Bell operating companies. In 1982, after years of litigation, and at the conclusion of the presentation of the Justice Department's and AT&T's cases in chief at trial, the parties agreed to a consent decree that provided for the divestiture of the Bell operating companies. The consent decree also set forth in detail structural changes containing restrictions designed to prevent the operating companies from discriminating against AT&T's competitors and to avoid a recurrence of the types of discriminating cross-subsidizations that

were alleged to be the basis of the lawsuit. *United States v. American Telephone & Telegraph Co., ibid.* at 142-143 (D.C.D.C. 1982).

The divestiture was to be accomplished by transfer of each of the Bell operating companies to one of seven new regional holding companies. The regional holding companies are separate from each other and from AT&T. Northwestern Bell and two other divested operating companies became subsidiaries of U S West, Inc., one of the regional holding companies. In satisfying the statutory obligations imposed by the Tunney Act, 15 U.S.C. § 16(e), to carefully scrutinize the proposed consent decree, the federal disctict court evaluated the debt-equity ratios to be assumed by the operating companies upon divestiture. *Id.* at 207-208, 226.

AT&T had stated its intention, to which the federal government agreed, to divest the operating companies, such as Northwestern Bell, with the debt component of its capital structure set at approximately forty-five percent. The Court required the proposed consent decree to be modified to incorporate a forty-five percent debt ratio, saying:

> The Court considers that its Tunney Act responsibilities require it to demand more of the parties on subjects which have significant public interest aspects than statements of intentions embodied in briefs or written comments, or made during oral argument. Accordingly, **the Court will require** that the proposed decree be modified to incorporate the forty-five percent debt ratio and the government's and AT&T's representations with regard to the quality of the Operating Company debt to the end that on the basis of such a modification, the Court will be in a position, if necessary, to insist that the statement of intention of the parties are actually implemented.

Id. at 207-208 (emphasis supplied).

In its order modifying the final judgment, the Court stated:

> At the time of the transfer of ownership provided for in section I(A) (4), the separated BOCs shall have debt ratios of approximately forty-five percent, (except for Pacific Telephone & Telegraph Company which shall

> have a debt ratio of approximately fifty percent), and the quality of the debt shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs at that time. Upon application by a party or a BOC, the Court may grant an exception to this requirement.

Id. at 226 (emphasis supplied).

Divestiture became effective on January 1, 1984, at which time Northwestern Bell was divested with a debt ratio in compliance with the Court's Order.

2. The 1983-84 Rate Proceedings Before the Public Utilities Commission.

Pursuant to Minnesota's Administrative Procedure Act, Minn. Stat. § 14, contested case hearings on Northwestern Bell's September 1983 petition for a rate increase, known as the "Docket 600" proceedings, were conducted by an administrative law judge between January and April, 1984. The rates were to be set on a test year approach using 1983, **adjusted to reflect the effects of the 1984 divestiture of AT&T**, as the test year.

In the 1984 Docket 600 proceeding, Northwestern Bell argued to the Commission that the use of any hypothetical capital structure based on an equity ratio of less than fifty-five percent equity would be "patently unfair and unlawful, regardless of the evidence." Initial Brief, April 30, 1984, at pp. 159-160. Northwestern Bell also specifically argued that the federal court's order mandating divestiture of the Bell operating companies had required them to employ debt ratios of approximately forty-five percent and that the imposition of a capital structure using less than a fifty-five percent equity ratio would conflict with the order of the United States District Court.

By Orders dated July 27, 1984 and September 26, 1984, the Commission granted Northwestern Bell a rate increase of more than $57 million and established the design of rates Northwestern Bell must use in marketing its services to various classes of customers. These decisions complied with the debt ratio set by the federal district court's divestiture order.

During the course of the 1984 rate proceedings, Northwestern Bell filed with the Federal Communications Commission ("the FCC") a tariff related to its decision, newly permitted by the FCC, to enter

the market for customer premises telephone equipment. In that regard, Northwestern Bell was required to undergo a change in its corporate structure. An intervenor in the Docket 600 rate case, Evan Henry, argued to the Minnesota Public Utilities Commission that the rate case should be dismissed because of Northwestern Bell's failure to earlier advise the Commission of the restructuring. The Commission voted against dismissing the rate petition on June 8, 1984, but to consider the effect of the restructuring in the context of the rate proceeding on rehearing. This procedure was followed, and the Commission's July 27, 1984, Order was reduced by $363,000 because of the restructuring. See Order after Reconsideration and Rehearing dated september 26, 1298 *infra* at p. A-50

3. The Evan Henry Appeal From the 1984 Rate Order.

Intervenor Henry appealed the Commission's decision. The Minnesota Court of Appeals reversed the Order of the Commission, stating that the rate case should have been dismissed. *Henry v. Minnesota Public Utils. Comm'n*, 376 N.W.2d 226 (Minn. App. 1985). The Minnesota Supreme Court reversed the decision of the Court of Appeals and reinstated the decision of the Minnesota Public Utilities Commission of September 26, 1984. *Henry v. Minnesota Public Utils. Comm'n*, 392 N.W.2d 209 (Minn. 1986), *infra* at p. A-100. The Minnesota Supreme Court held that the Commission had decided the case in accordance with statutory procedure. It also held, based on its "careful review of the evidence in the record of this case and the 100 page order of the MPUC," that the rate increase "was supported by the record and was not arbitrary and capricious." *Id.* at 216.

4. The Department of Public Service Investigation and the Re-Opening of the 1984 Rate Order.

Prior to the Minnesota Supreme Court's decision in *Henry*, the Commission ordered an investigation in the Docket 600 rate case. This investigation arose out of newspaper reports of ex parte contacts between certain members of the Commission and representatives of certain utilities. The investigation was conducted by the Minnesota Department of Public Service, and not in accordance with statutory contested case hearing procedures.

The Department found no evidence that Northwestern Bell violated any statutes or regulations, but stated that Northwestern Bell's

contacts with certain Commissioners had tainted the decision-making process.

The Commission took administrative notice of the report of the Department of Public Service's investigation, which included affidavits and memoranda of interviews or telephone conversations conducted by the Department of Public Service, without affording Northwestern Bell prior notice or an opportunity to examine the individuals.

On July 9, 1986, the Minnesota Attorney General petitioned to reopen and reconsider the Docket 600 rate case. In November 1986, the Commission began deliberating whether it should take further action on the Docket 600 rate case. On April 2, 1987, without employing contested case hearing procedures, the Commission issued an order vacating the 1984 rate decision (affirmed by the Supreme Court on the merits in *Henry, supra*) and reopening that case for redeliberation and issuance of a new decision and order.

On April 3, 1987, the Commission issued its new decision after redeliberation of the 1983-84 rate case. *Infra* at p. A-129. The Commission decided to make its new 1987 decision based on the same 1983 test year data, adjusted for divestiture, that constituted the record before the Commission in the original rate case. *Infra* at pp. A-146—A-147. No new contested case hearings were held, nor was Northwest ern Bell given the opportunity to orally argue its case to the Commission, the majority of which were new Commissioners not involved in the 1984 deliberations.

By its 1987 redeliberation, the Commission reduced Northwestern Bell's rates for telephone service from $57,148,000 to $45,603,000, and revised the 1984 Order in several significant respects. The largest single component of the Commission's 1987 reduction of Northwestern Bell's 1984 rate increase resulted from the Commission's rejection of Northwestern Bell's actual capital structure, approved in 1984 and mandated for that time period by the federal court's divestiture order, and the imposition in its stead of a hypothetical capital structure with a much higher debt ratio. The Commission held that Northwestern Bell's capitalization of approximately forty-five percent debt and fifty-five percent shareholders' equity was not reasonable for the 1984 time period and imputed to Northwestern Bell a structure consisting of 50.1 percent debt and 49.9 percent

equity, reducing the rate base and, as a result, decreasing the previously approved rate increase by about $10 million per year.

In its Order after Redeliberation on April 3, 1987, the Minnesota Public Utilities Commission held that the capital structure set by the federal court's divestiture order did not preclude the Commission from imputing a different capital structure to Northwestern Bell, saying:

> The Company also suggests that, somehow, to allow less than a 55% equity ratio would either violate or materially interfere with the decision of the Federal Divestiture Court and the MFJ. Again, the Company attempts to use an Order of the Federal Court which was not entered for regulatory ratemaking purposes to, largely, avoid the issue.

Infra at p. A-169.

5. 1987 and 1988 Appellate Proceedings.

Northwestern Bell appealed the Commission's decisions to the Minnesota Court of Appeals, which affirmed in an opinion filed December 29, 1987. *See In The Matter of the Minnesota Public Utilities Commission's Initiation of Summary Investigation*, 417 N.W.2d 274 (Minn. App. 1987), *infra* at p. 181.

Northwestern Bell pressed its due process arguments before the Minnesota Court of Appeals. The Court of Appeals rejected the claim that the denial of oral argument was a deprivation of the constitutionally guaranteed right to due process on the basis of the maxim, "He who seeks equity must do equity." *Infra* at pp. A-194—A-195 . Northwestern Bell also argued to the Court of Appeals that due process demanded that rates be fixed only after a formal hearing. Brief of Northwestern Bell Telephone Company to Court of Appeals, No. C7-87-1296, at pp. 47-49. The Court of Appeals opinion rejected this argument as well, stating that the Court had "considered Northwestern Bell's other arguments and find[s] them to be without merit." *Infra* at p. A-202.

Northwestern Bell sought discretionary review by the Minnesota Supreme Court of the decision of the Court of Appeals. The Petition for Review was denied on March 18, 1988. On April 4, 1988,

the Minnesota Supreme Court denied Northwestern Bell's timely Petition for Reconsideration of the denial of the Petition for Review. Northwestern Bell also raised the issues of federal preemption, due process and just compensation in its Petition for Reconsideration. *Infra* at pp. A-204 *et seq.* [1]

REASONS FOR GRANTING THE WRIT

I.

The federal court's order, entered pursuant to the Tunney Act, requiring Northwestern Bell's divestiture with a capital structure consisting of forty-five percent debt, preempted the Commission from imputing a different capital structure to Northwestern Bell.

Federal law preempts state law when state law actually conflicts with federal law, which arises when compliance with both federal and state law is impossible. *Michigan Canners & Freezers Ass'n, Inc. v. Agricultural Marketing and Bargaining Board,* 467 U.S. 461, 469 (1984).

The consent decree in the federal government's antitrust action was submitted to the federal district court before whom the anti-trust action was being tried for judicial consideration and approval. Pursuant to the Tunney Act, 15 U.S.C. § 16(e), the Court was required to carefully scrutinize the proposed consent decree. That statute provides that a proposal for a consent judgment submitted by the United States in an action brought under the anti-trust laws may not be entered by the Court without prior compliance with

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[1] Under Minnesota's Rules of Civil Appellate Procedure, a party may petition for rehearing of any order of the Minnesota Supreme Court. Rule 140.01, Minnesota Rules of Civil Appellate Procedure. In its petition for rehearing, the party must state any controlling statutes, decision or principle of law which, in petitioner's opinion, the Supreme Court has overlooked, failed to consider, misapplied or misconceived. *Id.* Because a Petition for Discretionary Review of a decision of the Court of Appeals is limited to a total of five double-spaced pages (including the statement of the case), *see* Minnesota Rule of Civil Appellate Procedure 117, subd. 3, the petition for rehearing, which has no length limitation, provides a meaningful method for raising these issues in some detail.

certain procedures, including a determination by the Court that the entry of the judgment is in the public interest. In making that determination, the Court is required to consider, among other things, the impact of the entry of such judgment upon the public generally, as well as the competitive impact of the judgment and the impact upon individuals alleging specific injury from the alleged violations. The Act allows the court to employ specific procedures including publication of a competitive impact statement by the Department of Justice and a sixty-day period for the receipt of public comments. Interpreting the Tunney Act's requirements, the Court stated: "It is clear that Congress wanted the courts to act as an independent check upon the terms of the decrees negotiated by the Department of Justice, and this Court will review the instant settlement in that spirit." *Ibid.* at 149 (footnote omitted).

The federal district court, in the exercise of its Tunney Act obligations, specifically added to the consent decree its order that the Bell Companies to be divested, **effective January 1, 1984,** with a debt to equity ratio of forty-five percent. *Ibid.* at 207-208, 226.

The federal district court's decision was not contingent upon state regulators' approval of the debt-equity ratio. One of the Bell operating companies, Pacific Telephone Company, had at the time of the modification of final judgment a substantially higher debt-equity ratio of approximately fifty-seven percent. The Court did not require AT&T to reduce Pacific Telephone's debt to forty-five percent, but accepted a reduction of debt to around fifty percent. The Court did not condition its order on approval by the State of California of the ratio. Thus, in assessing its obligations imposed by Congress in the Tunney Act, the federal district court imposed the requirement that Pacific Telephone & Telegraph use a fifty percent debt-equity ratio, notwithstanding the use by California regulators of a much higher debt-ration equity ratio. *Ibid.* at 208 n.320.

In 1983, several parties to the antitrust case attempted to convince the federal district court that the capital structure imposed by the Modification of Final Judgment was inequitable, in part because the various Bell companies operated under different tariffs. The Court disagreed, saying:

> Because the decree provides that the operating companies and AT&T will each receive a portion of the consol-

> idated debt and equity of the Bell System[59], it is reasonable for each of the post-divestiture entities also to receive a corresponding portion of the system's pre-divestiture business risks which encumber equity.
> ***
>
> [59]The decree provides that AT&T is to divest the operating companies with 45 percent debt ratios (55 percent equity) ...

United States v. Western Electric Co., Inc., 569 F. Supp. 1057, 1072 (D.D.C. 1983).

The Minnesota Public Utilities Commission, in its Order after Redeliberation in 1987, claimed to have used Northwestern Bell's results for test year 1983, **adjusted to reflect the effects of divestiture.** It, however, reversed its 1984 position on the appropriateness of Northwestern Bell's actual debt-equity ratio. It held instead that 6.3 percent of Northwestern Bell's actual equity be disallowed as equity and considered to be imputed debt. This created a hypothetical capital structure of 50.9 percent debt and 49.1 percent equity, instead of the federal court ordered ratios of approximately forty-five percent debt and fifty-five percent equity. This had the legal effect of declaring the federal court-ordered debt-equity ratio to be unreasonable, and the financial effect of lowering Northwestern Bell's revenue by ten million dollars per year.

The action of the Minnesota Public Utilities Commission is barred by the Supremacy Clause for precisely the same reasons announced by the Court on June 24, 1988, in *Mississippi Power & Light Co. v. Mississippi*, 56 U.S.L.W. 4751 (No. 86-1970). In *Mississippi*, the Court held that a decision of the Federal Energy Regulatory Commission ("FERC") that required Mississippi Power & Light Company to purchase thirty-three percent of the output of a nuclear power plant at rates determined by FERC to be just and reasonable preempted the State of Mississippi from inquiring into the prudence of an increase in retail rates sought by Mississippi Power & Light to incorporate that cost. Mississippi Power & Light argued that costs incurred by it pursuant to order of FERC must be recognized by Mississippi as reasonable, and that Mississippi

could not second-guess FERC's determination by the exercise of its authority over state rate-making. The Court broadly interpreted its 1986 decision in *Nantahala Power and Light Company v. Thornburg*, 476 U.S. ___, 90 L.Ed. 2d 943 (1986), and stated:

> The reasoning that led to our decision in *Nantahala* applies with equal force here and compels the same conclusion—states may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair. FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates.

56 U.S.L.W. at 4756. In both *Nantahala* and *Mississippi*, the Court concluded that states were without authority to set intrastate rates based on their assumption that the utilities' adherence to federal orders was unreasonable.

The Minnesota Public Utilities Commission has attempted to "invade the province of federal authority" in the same way and to the same extent as did the State of Mississippi. 56 U.S.L.W. at 4757. The Minnesota Commission determined it was unreasonable for Northwestern Bell to use, upon divestiture in 1984, the very debt-equity ratio in its capital structure that the federal court, in the exercise of its Tunney Act obligations, ordered Northwestern Bell to use. It decided to ignore the federal court order because it was not entered "for regulatory ratemaking purposes." The federal court's determination may not be collaterally attacked by a state or in the state courts in the exercise of state rate-making authority.[2]

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[2]The decisions of the Minnesota Court of Appeals and the Minnesota Supreme Court were annnounced prior to the United States Supreme Court's June 24, 1988, decision in *Mississippi Power & Light Co. v. Mississippi*, 56 U.S.L.W. 4751 (No. 86-1970) and the Minnesota courts therefore could not have had the benefit of this significant pre-emption decision. In the event that the Court determines not to fully hear this matter, Northwestern Bell respectfully requests that the Court remand the case to the Minnesota courts for reconsideration in light of *Mississippi Power & Light Co. v. Mississippi, supra*. The Court employed this procedure in *Gates v. United States Postal Service*, 470 U.S. 1079 (1985).

In *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. ___, 90 L.Ed.2d 943 (1986), the state was held preempted from setting retail gas rates based on a state's conclusion that the interstate wholesale gas rates approved by the Federal Energy Regulatory Commission ("FERC") under the Natural Gas Act, 15 U.S.C. § 717 *et. seq.*, were unreasonable. *Ibid.*, 90 L.Ed.2d at 954. Although the federal regulators had no direct authority over the regulation of **retail** intrastate gas rates, the state was preempted from rate-making actions based on any conclusion that the federal regulators' decisions were unreasonable. The action of the Minnesota Public Utilities Commission is preempted based on precisely the same logic as was the state's rate-making decision in *Nantahala*: the state may not premise its rate-making on the perceived unreasonableness of a decision by a federal decision-maker in the proper exercise of powers granted by federal statute.

The conclusion that the Public Utilities Commission's action is preempted is also buttressed by the Supreme Court's decision last term of *Schneidewind v. ANR Pipeline Co.*, 485 U.S. ___, 99 L.Ed.2d 315 (1988). The Court held that the regulation of interstate gas rates by FERC pre-empted the state's enforcement of a statute, intended for the protection of the state's ratepayers and investors, regulating the issuance of securities by gas companies. The federal statute, which permitted FERC to impute a reasonable capital structure to the utility if it found the utility's capital structure unreasonable, "permits FERC to control, albeit indirectly [the utility's] capital structure." *Ibid.* at 326. The state's refusal to permit a proposed securities offering based on its belief that the Company would thus be rendered under- or over- capitalized constituted impermissible interference with the federal regulatory authority.

Other state utility regulatory commissions have agreed that for the post-divestiture period, the capital structure requirements of the federal court's Modification of Final Judgment control for rate-making purposes. In *Illinois Bell Telephone Co.*, 57 P.U.R. 4th 225, 263 (Ill. Comm. Comm'n 1983), the Illinois Commerce Commission refused to impute a hypothetical capital structure as a result of the Modified Final Judgment. In *Chesapeake Potomac Tel. Co.* 74 Md. P.S.C. 595 (1983), the Maryland Public Service Commission reached the same result, saying:

> We are persuaded that the MFJ (the federal court order) **leaves no alternative** other than for C&P Telephone Company of Maryland to be divested with a capital structure which is not in excess of 45 percent debt. Since this is a legal requirement established by the U.S. District Court and is binding upon AT&T as well as the divested local operating companies, we conclude that we should adopt a capital structure that conforms with that requirement .... As a consequence, the Modification of Final Judgment will establish, for practical purposes, the maximum amount of debt capital which will comprise the Company's capital structure throughout much of the rate-effective period.

(emphasis supplied).

Thus, as a matter of federal constitutional law, the Public Utilities Commission was precluded from imputing to Northwestern Bell a debt-equity ratio that the Company was prohibited by federal court order from actually using.

II.

Northwestern Bell was deprived of its constitutional right to procedural due process.

In significantly reducing Northwestern Bell's rate increase, the Commission ignored the procedural safeguards of the United States Constitution which protect due process rights. Although the Supreme Court has historically refused to mechanically define "due process" as that phrase is used in the Constitution, *Green v. Frazier*, 253 U.S. 233, 238 (1920), the Court has noted that, with respect to cases involving the deprivation of property, a hearing appropriate in the circumstances is reguired. *See Parratt v. Taylor*, 451 U.S. 527 (1981), *overruled* "to the extent that it states that mere lack of due care by a state official may 'deprive' an individual of life, liberty, or property under the Fourteenth Amendment" by *Daniels v. Williams*, 474 U.S. 327, 330 (1986). Specifically, the Court in *Parratt* stated:

> Our past cases mandate that some kind of hearing is required at some time before a State finally deprives a person of his property interests. The fundamental requirement of due process is the opportunity to be heard and it is an "opportunity which must be granted at a meaningful time and in an meaningful manner."

401 U.S. at 540, *quoting Armstrong v. Manzo*, 380 U.S. 545, 552 (1965); *see also, Market Street Railway Co. v. Railroad Commission*, 324 U.S. 548, 558 (1945) (notice and hearing required). In conjunction with providing parties an opportunity to be heard at a meaningful time and in a meaningful manner, due process requires "that state action, whether through one agency or another, should be consistent with the fundamental principles of liberty and justice which lie at the base of all our civil and political institutions ...." *Hebert v. Louisiana*, 272 U.S. 312, 316 (1926).

With respect to administrative proceedings, the Court has distinguished an agency's rule-making authority (wherein no hearing is required) from it adjudicative authority (wherein a hearing is required). *See United States v. Florida East Coast Railway Co.*, 410 U.S. 224, 244-45 (1973). The distinction that the Court makes is based upon whom is affected by the agency's determination — an entire class of parties or an individual party. If only an individual party is involved, such as a single citizen or a single utility, the agency is said to utilize its adjudicative authority and a hearing is required. *Id. See also, Ohio Bell Telephone Co. v. Public Utilities Commission*, 301 U.S. 292 (1937); *Londoner v. Denver*, 210 U.S. 373 (1908); *cf. Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U.S. 441 (1915). Because the Commission's rate determination covered only Northwestern Bell, it is unquestionable that the Commission was acting in an adjudicative capacity and therefore a hearing was constitutionally required to protect Northwestern Bell's rights to due process.

In sharp contrast to what was required by the Constitution, the Commission, at the time Northwestern Bell's rate increase was reduced in 1987, did not afford Northwestern Bell a meaningful opportunity to be heard on the reduction. No contested case hearing was held. No oral argument before the newly constituted Com-

mission on the factual or legal basis for the adjusted rates was allowed. As a result, the Commission violated Northwestern Bell's procedural due process rights.

This conclusion is not altered by the fact that the Commission held a contested case hearing at the time the original rate increase was considered in 1983. That contested case hearing did not contemplate that the rate determination would ultimately be re-opened by a new Commission some four years later. Consequently, the 1983 hearing cannot satisfy due process requirements. To hold to the contrary, as the Minnesota Court of Appeals did, would allow a utilities commission to reduce utility rates without a meaningful hearing so long as a hearing was held at the prior rate determination. Surely, the opportunity to be heard is required prior to a rate reduction.

In reviewing the Commission's conduct, the Minnesota Court of Appeals committed a number of errors with respect to due process rights in affirming the Commission's rate determination. First, the Court of Appeals ignored the punitive nature of the rate reduction. A need for a hearing is enchanced dramatically by the fact that Northwestern Bell was being punished by the Commission for alleged impropriety at the time the rate was increased in 1984.

Second, in addition to being punitive in nature, the decision to reduce the rate increase was politically motivated in that the Commission was taking action against Northwestern Bell in response to media-induced public perceptions concerning the ratemaking process, rather than facts established on a contested case record. Under these circumstances, it cannot be said that the procedure followed by the Commission conformed with notions of fundamental fairness.

Northwestern Bell was deprived of its property by the Commission without a constitutionally required opportunity to be heard. Such disregard of fundamental procedural safeguards should not have been condoned by the Minnesota Court of Appeals under the guise of deference to an administrative agency. *See St. Joseph Stock Yards Co. v. United States,* 298 U.S. 38, 51 (1936). Therefore, the Supreme Court should grant review of the matter to correct the procedural due process errors committed by the Minnesota Court of Appeals.

III.

The State of Minnesota took Northwestern Bell's property without just compensation.

By ignoring Northwestern Bell's actual capital structure and using a hypothetical capital structure for rate making purposes, the Commission reduced Northwestern Bell's annual rate increase by ten million dollars. In doing so, the Commission has taken property from Northwestern Bell without just compensation in violation of the Fourteenth Amendment of the United States Constitution.

The Supreme Court has spoken numerous times with respect to the standard for determining whether property has been taken without just compensation by government regulatory agencies. The question is whether the Commission's rate structure provides adequate compensation to Northwestern Bell for the loss of its property. The Supreme Court has noted previously that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used, at the time it is being used to render the service, are unjust, unreasonable, and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.

Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679, 690 (1923). *See also, West v. Chesapeake & Potomac Telephone Co.*, 295 U.S. 662, 671 (1935).

The Court subsequently provided some direction with respect to the interests to be considered in setting rates. In *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the Court noted:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock .... By that standard the return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding

> risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 603 (citations omitted). Thus, the critical issue in determining whether the rate structure constitutes a taking is whether that rate structure guarantees an adequate rate of return on Northwestern Bell's equity so as to provide it with just compensation for the property it loses through the dedication of that equity to public use.

The Commission imputed to Northwestern Bell a hypothetical capital structure that contained a substantially lower amount of equity than Northwestern Bell in actuality had dedicated to its investment in regulated telephone service. As a result, the Commission ignored a portion of the equity on which Northwestern Bell is entitled, by constitutional guarantee, to earn a reasonable rate of return. The Commission thus has prevented Northwestern Bell from earning a fair return on its investment and has taken Northwestern Bell's property without just compensation in violation of the United States Constitution.

CONCLUSION

For these various reasons, the Petition for Certiorari should be granted.

Respectfully submitted,

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